United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

Original - Affidavit of Bailey

74-1062, 1816

To be argued by
HENRY A. BRACHTL

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket Nos. 74-1062, 74-1816

UNITED STATES OF AMERICA and MORTIMER TODEL, as Receiver of the funds, assets and property of Roosevelt Capital Corporation,

Plaintiffs-Appellees,

—against—

FRANKLIN NATIONAL BANK,

Defendant-Appellant.

APPEAL FROM MEMORANDUM DECISION AND ORDER AND JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK

BRIEF FOR PLAINTIFFS-APPELLEES

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BRIEF FOR PLAINTIFFS-APPELLEES

Issue Presented for Review

Whether the undisputed facts of this case warrant the District Court's determination that Franklin National Bank had sufficient knowledge of the misappropriation of the funds of its depositor, Roosevelt Capital Corporation, to be held liable for the loss that occurred.

Statement of the Case

Roosevelt Capital Corporation ("RCC") was a "small business investment company" (15 U.S.C. § 681, *et seq.*) which, early in 1962, borrowed $150,000 from the United States Small Business Administration. In 1964, after RCC had breached certain conditions, these funds became payable to the United States. A. 143-144.*

* Citations to the Joint Appendix appear as "A. —."

The United States subsequently obtained judgment by default against RCC and one of its purported officers. *United States* v. *Roosevelt Capital Corp., et ano,* S.D.N.Y. 65 Civ. 162, Aug. 3, 1966. However, the judgment remains unsatisfied because RCC's assets have all been unlawfully dispersed and dissipated, or "looted." A. 143-144.

Among those persons primarily responsible for the looting, three—Peter Francis Crosby, Raymond Pierson and Joseph Calise—were convicted for criminally misapplying, embezzling and/or purloining RCC's funds in violation of 18 U.S.C. § 657. *United States* v. *Crosby, et al.,* S.D.N.Y., Docket No. 69 Cr. 404, judgments of conviction, March 26, 1971 and May 14, 1971; *aff'd,* 2d Cir. No. 71-1516, Sept. 16, 1971; *cert. denied,* 405 U.S. 917 (1972).

This action arises out of the initial step in the looting of RCC, the purchase of RCC with $160,000 of its own funds, a fraudulent diversion of RCC's assets which reduced RCC to insolvency.*

In this action, the United States as RCC's creditor and Mortimer Todel as RCC's Receiver sue Franklin National Bank, RCC's depository, to recover $160,000, the amount by which Franklin charged RCC's corporate account to extinguish the personal debt to Franklin incurred by one of the buyers (and looters) of RCC in purchasing RCC.

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* Prior to this transaction, RCC had assets of approximately $305,000, liability to the United States of approximately $150,000, and capital of $155,000. Affidavit of Henry A. Brachtl, "Material Fact No. (3)", and exhibits thereto, A. 48-50. The dispersal and dissipation of the $145,000 balance of the RCC assets through subsequent transactions, after the initial misappropriation of $160,000, have been held not to be subjects of or the basis of the Decision and Order as amended. Memorandum Decision and Order, May 9, 1974. A. 599.

The District Court * granted summary judgment in favor of the United States and the Receiver for $157,229.17 plus interest from February 8, 1964. Memorandum Decision and Order, A. 531, as amended by Memorandum Decision and Order, A. 599.

Franklin appeals, contending that Franklin's charge of $160,000 against RCC funds on deposit was lawful in the circumstances, even as against RCC's creditor the United States, and RCC's receiver.

The Facts Relevant to the Issue Presented for Review

There is no genuine issue as to any material fact.

The absence of dispute as to the material facts is emphasized by the District Court's statement of the undisputed facts upon which summary judgment rests in this case, which largely adopts, as comparison discloses, the factual narrative of the affidavit of Franklin's former officer, Patrick J. Mastronardo, submitted in opposition to the motion for summary judgment. Memorandum Decision and Order, "FACTUAL BACKGROUND," A. 531, 534-539; Mastronardo affidavit, A. 515.

To further emphasize the absence of dispute as to the material facts, the United States and the Receiver adopt and incorporate herein the District Court's statement of "FACTUAL BACKGROUND" as the most accurate and detailed statement of the undisputed material facts upon which the District Court's summary judgment rests.

In adopting the factual narrative of the Mastronardo affidavit, the District Court excised conclusory assertions of the affidavit which are contrary to the very facts recited. Like the Court's statement, Franklin's "Statement of the

* Leonard P. Moore, Senior Circuit Judge, sitting by designation.

Case" in its brief on appeal, p. 4, also largely restates the factual narrative of the Mastronardo affidavit. However, the Franklin statement asserts anew the unfounded conclusory assertions excised in the Court's statement, and for that reason cannot be adopted by the United States and the Receiver.*

Summary of Argument

I. The District Court correctly held that Franklin's complete knowledge of the fraudulent diversion of the funds of its corporate depositor, RCC, rendered Franklin liable to RCC and to RCC's creditor to restore the misappropriated funds.

II. Franklin has no defense to the claims of RCC's Receiver and of the United States, RCC's creditor.

A. The sham resolution purportedly authorizing Pierson to direct charges against the RCC account cannot be given legitimacy by declaring it "simultaneous" with other steps in the transaction.

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* For example, Franklin asserts that, notwithstanding Franklin's issuance of its cashier's checks for $160,000 for tender by the buyers as the purchase price for the RCC shares, "Franklin had made no loans or advances of any kind to any of the purchasers of Roosevelt." Franklin Brief, p. 8. Franklin also asserts that, notwithstanding the undisputed facts, logic and the law, the buyers' act in requesting the Franklin's cashier's checks and Franklin's act in debiting RCC's account were corporate acts done at the insistence of RCC, the very corporate depositor which was the subject of the sale. Franklin Brief, pp. 7-8. These assertions are harbingers of Franklin's two-part argument that, if the corporate depositor, by whatever trick or device, could be caused (i) to give to the bank, or (ii) to "ratify" the bank's taking of, its deposits, even in fraud of creditors, then Franklin, though a knowing recipient of the corporate funds without consideration to the corporation, would be without liability to make restoration. That that argument is spurious will be shown below.

B. The Pierson letter was not an order to Franklin to issue checks and charge them against RCC's account.

C. Pierson's unauthorized instruction to charge the RCC account for the purchase money cashier's checks cannot be deemed ratified after the fact.

D. Even if RCC could be deemed to have authorized or ratified a request by Pierson to disburse RCC deposits to Franklin without consideration, Franklin would be liable to restore the funds as proceeds of a fraudulent conveyance.

E. Even if Franklin was not the recipient of the misappropriated RCC deposits, the bank would remain liable in damages.

CONCLUSION—The decision and order of the District Court granting summary judgment to the United States and the Receiver of RCC, and the judgment entered accordingly, should be affirmed.

ARGUMENT

I.

The District Court correctly held that Franklin's complete knowledge of the fraudulent diversion of the funds of its corporate depositor, RCC, rendered Franklin liable to RCC and to RCC's creditor to restore the misappropriated funds.

The purchase of RCC with its own funds was patently a fraud on the corporation and the corporation's creditor, the United States. If fresh support is needed for that proposition, it is found in the recent judicial treatment of remarkably similar facts in *Superintendent of Insurance of N. Y.* v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971). The Supreme Court briefly described what it called simply "the fraudulent scheme," 404 U.S., at 8, in that case:

> "It seems that Bankers Life & Casualty Co., one of the respondents, agreed to sell all of Manhattan's stock to one Begole for $5,000,000. It is alleged that Begole conspired with one Bourne and others to pay for this stock, not out of their own funds, but with Manhattan assets. They were alleged to have arranged, through Garvin, Bantel & Co.—a note brokerage firm—to obtain a $5,000,000 check from respondent Irving Trust Co., although they had no funds on deposit there at the time. On the same day they purchased all the stock of Manhattan from Bankers Life for $5,000,000 and as stockholders and directors, installed one Sweeny as president of Manhattan.
>
> "Manhattan then sold its United States Treasury bonds for $4,854,552.67. That amount, plus enough cash to bring the total to $5,000,000, was credited to an account of Manhattan at Irving Trust and the $5,000,000 Irving Trust check was charged against it.

> As a result, Begole owned all the stock of Manhattan, having used $5,000,000 of Manhattan's assets to purchase it." 404 U.S., at 7-8 (footnote omitted).

The factual similarity of that "fraudulent scheme" to the one in the case at bar is dramatically shown by simply inserting in the Supreme Court's description the details and names of principals here:

> "It seems that [Tolmage] agreed to sell all of [Roosevelt's] stock to [Olanow-Pierson] for [$160,000]. It is alleged that [Olanow-Pierson] conspired with one [Crosby] and others to pay for this stock, not out of their own funds, but with [Roosevelt's] assets. They were alleged to have arranged, through [Mastronardo, a bank officer] to obtain a [$118,000 and a $42,000] check from [Franklin National Bank, Hanover Sq.], although they had no funds on deposit there at the time. On the same day they purchased all the stock of [Roosevelt] from [Tolmage] for [$160,000] and as stockholders and directors installed [Pierson] as [vice-]president of [Roosevelt].
>
> "[Roosevelt had] sold its United States Treasury [bills] for [$187,000]. That amount . . . was credited to an account of [Roosevelt] at [Franklin National Bank, Hanover Sq.] and the [$118,000 and $42,000 Franklin National] check[s] [were] charged against it. As a result, [Olanow-Pierson] owned all of the stock of [Roosevelt], having used [$160,000] of [Roosevelt's] assets to purchase it."

The Supreme Court, reversing the courts below, held that the "fraudulent scheme" was within the prohibitions of Section 10(b) of the Securities Exchange Act of 1934 and S.E.C. Rule X10b-5, and was therefore within the jurisdiction of the federal courts. Although the lower courts had not found federal jurisdiction, they recognized the "fraudulent scheme" for what it was. The district court, for example, though finding no federal jurisdiction, noted that the complaint, taken as a whole, alleged "a common law action for

misappropriation of corporate funds by a fiduciary, embezzlement or fraudulent conveyance perhaps, or the distribution of an illegal dividend." 300 F. Supp. 1083, 1102 (S.D.N.Y. 1969).

As the District Court in this case has observed, "[t]he philosophy and legal consequences of *Superintendent of Insurance of New York* v. *Bankers Life & Casualty Co., et al.*, 404 U.S. 6 (1971) are equally applicable here." A. 18.

Here, Franklin participated in the fraudulent purchase of RCC with RCC's own funds by advancing the purchase money to the buyers and obtaining reimbursement from the RCC account.

Specifically, the undisputed facts show that, during the closing on the sale of the shares of RCC at Franklin, Franklin's assistant cashier, Mastronardo, furnished to the buyers, at their request, Franklin cashier's checks for $160,000, payable to the sellers' representative, Sidney Tolmage. The cashier's checks for $160,000 were intended and used to effect the buyers' purchase of RCC, as Mastronardo knew at the time. At the time of the closing, more than $187,000 was on deposit in RCC's corporate account at Franklin. Mastronardo obtained reimbursement for Franklin for the checks by debiting RCC's corporate account for the $160,000.

Franklin's issuance of the cashier's checks did not, of itself, generate a charge against the RCC account, as would have been the case on presentment of an ordinary check written against that account. A cashier's check constitutes an acknowledgement of an indebtedness on the part of the bank to the payee, and is thus quite unlike an ordinary check drawn on specific deposits on balance. *Robert Arnold Mfg. Co.* v. *Troy Associates, Inc.*, 226 N.Y.S. 2d 333 (Sup. Ct. N.Y. Co. 1962); 6 Michie, *Banks and Banking*, Ch. 12, § 13. A cashier's check or official check "is a bill of exchange drawn by a bank on itself. . . . It is a draft, a primary obligation of the bank, or *a form of a check by*

which the bank lends its credit to the purchaser of the check. . . ." 6 Michie, *supra.* (Emphasis added.)

Thus, the issuance of the cashier's checks in this case created no charge against the RCC account, but did create an obligation of Franklin to the payee, Tolmage, and a corresponding "personal debt of Pierson and his associates" to Franklin. Memorandum Decision and Order, A. 547.

Notwithstanding that the cashier's checks created a personal debt of Pierson and his associates to Franklin and not a corporate debt of RCC, and although no consideration passed to RCC, Franklin obtained reimbursement by debiting the account of the corporation.

To this situation must be applied the principle applied by the District Court, A. 546, that

> ". . . where a bank accepts payment of any indebtedness with knowledge that the debtor is wrongfully using moneys which do not belong to him, the bank becomes a participant in the debtor's wrongful act," *Grace* v. *Corn Exchange Bank Trust Co.,* 287 N.Y. 94, 105 (1941),

and,

> "[n]either a large bank nor a small bank may urge that it is ignorant of facts clearly disclosed in the transactions of its customers with the bank . . . ; nor may a bank close its eyes to the clear implications of such facts." 287 N.Y., at 107.

Stated another way, Franklin cannot be heard to profess good faith in accepting RCC corporate assets for Pierson's obligation:

> "Bad faith in taking commercial paper does not necessarily involve furtive motives, for its exists when the purchaser has notice of facts which, if unexplained, would show that he was taking the

> property of one who . . . 'owed him nothing, in payment of a claim that he held against some one else. . . .'" *Ward* v. *City Trust Co. of N.Y.*, 192 N.Y. 60, 73 (1908).

Ward v. *City Trust Co. of N.Y.* is similar to the instant case. There, two men borrowed $125,000 from City Trust Co. with which to purchase all the stock of a manufacturing corporation. As in this case, "[n]o part of the proceeds of the loan was turned over to the [corporation] or used for its benefit. . . ." 192 N.Y., at 66.

Thereafter, to repay their purchase money loan, the new owners gave a note of the corporation to another bank ostensibly for a loan of $125,000 to the corporation. The loan was made, in the form of a bank check payable to the corporation. The perpetrators then endorsed the corporation's check to City Trust in satisfaction of their personal indebtedness.

On these facts, the Court declared that "[t]he form of the check in question was notice to the trust company that Umsted was using the property of the corporation of which he was president to pay the personal debt of himself and Kiefer in apparent violation of its rights." 192 N.Y., at 69.

"The effect of such notice," the Court stated,

> ". . . was to put the trust company upon inquiry to see whether it was about to accept money from one to whom it did not belong in payment of its own claim."

The Court continued:

> "The presumption arising from the face of the check was that it belonged to the Hartman Company and its president had no right to use it to pay his personal debt. The purpose of the law in exacting in-

> quiry under such circumstances is to see whether the apparent situation is the actual situation, or in other words, to learn whether facts exist to rebut the presumption." 192 N.Y., at 69-70.

The Court concluded:

> "In the case before us no inquiry was made, although the check was for so large an amount as to induce a prudent man to proceed with caution. The transaction upon its face involved a gift to Umsted and Kiefer, or the theft by them, of a large portion of the assets of the Hartman Company, and under such extraordinary circumstances reasonable inquiry meant one prosecuted with a degree of diligence adapted to those circumstances." 192 N.Y., at 70-71.

The bank was therefore compelled to restore the corporate funds on a judgment in favor of the corporation's judgment creditor. See also, *Aetna Casualty & Surety Co.* v. *Catskill Nat'l Bank & Trust Co.*, 102 F.2d 527 (2d Cir. 1939).

In this case, Franklin contends that it was authorized to charge the $160,000 against the RCC account by the letter from Pierson requesting the cashier's checks. Franklin contends that Pierson's authority to instruct Franklin to charge the RCC account before he had even purchased the shares of RCC derived from a certificate of corporate resolution designating Pierson a signatory for the RCC account and also presented prior to the consummation of the sale.

The District Court made the following observations about the undisputed facts of the transaction and the bank's knowledge:

> "The corporate resolution, which purported to authorize Pierson, as vice-president of RCC, to pay out RCC funds as he saw fit, was delivered to Mastronardo on May 14 before the sale of the RCC stock

> was completed. At that time Mastronardo certainly knew that Pierson and the others who signed the resolution (allegedly as president and secretary) were not then officers of RCC. . . Similarly, when he received the letter described above by which Pierson purported to 'authorize' Franklin to pay out $160,000 of RCC funds, Mastronardo in fact knew that Pierson was not then in a position to issue such instructions regarding RCC funds.
>
> ". . . Whatever Mastronardo thought about the reasons why he was being asked to issue Franklin's official checks, he well knew (1) that Pierson and Olanow were purchasing the stock held by stockholders represented by Tolmage; (2) that Pierson and Olanow themselves had no acceptable funds to purchase the stock; and (3) that when Pierson delivered the letter purporting to authorize Franklin to pay out $160,000 of RCC funds, he had no proper authority to do so. Under these circumstances I believe it is crystal clear that Franklin improperly reimbursed itself for its issuance of official checks from RCC corporate funds without proper authority." Memorandum Decision and Order, A. 544-546.

The District Court observed that the decisions, in "the litany of cases cited by both plaintiffs and defendant . . . turn on whether the particular facts in each case warrant a finding that the bank had sufficient knowledge of the activities of the party misappropriating funds so that it could be held responsible for the losses that occurred." A. 546.

Even *Field* v. *Bankers Trust Co.*, 296 F.2d 109 (2d Cir. 1961), *aff'g*, 184 F. Supp. 23 (E.D.N.Y. 1960), heavily relied upon by Franklin, rested, as the District Court noted, "on the specific findings that defendants had no knowledge of any improprieties with respect to any of the challenged transactions." A. 548. "This case," the District Court con-

tinued, "presents no such situation." A. 548. In fact, the District Court concluded,

> "Adopting Franklin's version of the facts, I am nevertheless compelled to conclude that this is a classic case of 'actual knowledge,' and one which is far stronger than the cases cited by plaintiffs." Memorandum Decision and Order, A. 551.

The District Court explained:

> "In the instant case there is no dispute that Mastronardo, an officer of Franklin, knew that the RCC shareholders were selling all their interest in the corporation for $160,000. He confirmed by telephone that the amount of cash in RCC's account was just over $187,000. Under these circumstances there is no doubt that when it honored Pierson's letter, issued checks for $160,000, and later charged them to RCC's account, Franklin had *actual knowledge* that it was applying corporate funds to cover the personal debt of Pierson and his associates and that it was doing so without proper authorization from RCC. (*See Grace* v. *Corn Exchange Bank, supra; Aetna Cas. & Surety Co.* v. *Catskill Nat'l Bank & Trust Co., supra.*) Then too, Mastronardo knew that the $160,000 was the purchase price for all of the stock of RCC and that this sum was equal to some 85% of all the funds RCC had on deposit with Franklin. (*See Ward* v. *City Trust Co., of N.Y., supra.*)
>
> ". . .
>
> ". . . Under Franklin's own version of the facts, it had actual knowledge which may be termed, at the very least, embarrassingly complete." Memorandum Decision and Order, A. 547-548. (Emphasis in original.)

The District Court concluded:

> ". . . Thus, I believe that the papers before me clearly establish that Franklin paid out $160,000 of RCC funds pursuant to a purported corporate resolution which it knew was invalid. Under these circumstances, these funds must be returned to the corporation." Memorandum Decision and Order, A. 548.

It is submitted that the undisputed facts and the applicable principles of law permit no other conclusion.

II.

Franklin has no defense to the claims of RCC's Receiver and of the United States, RCC's creditor.

A. The sham resolution purportedly authorizing Pierson to direct charges against the RCC account cannot be given legitimacy by declaring it "simultaneous" with other steps in the transaction.

Franklin professes to have relied upon a certificate of corporate resolution designating Pierson as an RCC account signatory.

No doubt because of *Ward* v. *City Trust Co. of N. Y., supra,* and similar cases, the form certificate of resolution relied upon by the bank does contain an exculpatory clause, which recites that the bank may pay or charge instruments against the corporate account

> ". . . without inquiry as to the circumstances of issue, negotiation or indorsement thereof or as to the disposition of the proceeds thereof, even if drawn, indorsed or payable to cash, bearer, or to the individual

> order of any signing officer, agent or signatory, or tendered in payment of his individual obligation." A. 105.

This disclaimer could not avail the bank here, however, for the resolution purports only to relieve the bank of the duty to inquire, and affords no immunity where the bank actually knows of a misappropriation. As the Fourth Circuit Court of Appeals recently stated:

> "The courts are unanimous in voiding attempts to create exceptions to liability for future wilful acts or gross negligence. 6 Williston, *Contracts* § 1751B (1938). Certainly any agreement protecting a bank from liability for assisting a fiduciary in a misappropriation when the bank acts in 'bad faith' or with actual knowledge of the fiduciary's breach would come within this rule." *Maryland Casualty Co.* v. *Bank of Charlotte,* 340 F.2d 550, 555 (4th Cir. 1965).

Here, the Franklin's knowledge of the fraudulent misappropriation and its bad faith begin with the bank's knowledge that the very certificate of resolution now relied on by the bank was a nullity and a sham, and obviously so, at the time Franklin issued the cashier's checks for Pierson and debited the RCC account. At that time, Pierson was not in law or in fact a shareholder and therefore could not elect himself a director or appoint himself an officer of RCC. See, N.Y. Business Corporation Law, §§ 612, 614, 703 and 715. Indeed, all those represented as officers of RCC were not such, and this, too, was known to Franklin.

Franklin protests that "although the corporate resolutions and instructions were executed prior to the consummation of the purchase and sale of Roosevelt, nevertheless, in fact and in law the instructions and resolutions must be deemed effective *simultaneously* with the sale of the stock." Franklin's Brief, pp. 10-11.

However, advancing the speed of this transaction to simultaneity might blur but cannot obscure Franklin's two step role of issuing checks for Pierson's use and then debiting the corporate account.

This transaction, like the hypothetical, conventional, "simultaneous" real estate closing offered by Franklin as an analogue, is subject to judicial examination and contemplation. Such an examination will show Franklin's analogy to be false.

The very function of the "simultaneous" real estate closing is to protect creditors. Thus, in such a transaction, the buyer's creditor advances the purchase price and then and there receives a security interest in the property being purchased. The seller's creditor immediately receives so much of the purchase price advanced as will satisfy and extinguish his security interest and permit the seller to transfer unencumbered title.

Here, too, the buyers' creditor, Franklin, advanced the purchase price to enable Pierson to purchase the RCC shares from Tolmage. There, however, the similarity ends. Franklin claims not to have taken the shares in pledge, though it held them after the sale (a claim not disputed on this motion). Whether or not Franklin collateralized its advance, it soon obtained reimbursement, not, however, from any party to the sale. Instead, Franklin obtained reimbursement from the RCC corporate account. The interests of neither the corporation nor its creditor the United States were represented at the closing, and with telling results:

After the closing, the sellers had Franklin's cashier's checks, as good as cash; Pierson had the shares of RCC; the bank was reimbursed; and RCC, to the ultimate injury of its creditor, was out $160,000.

In sum, while the conventional "simultaneous" real estate closing operates as a legitimate device to protect creditors, it bears small resemblance to the fraudulent fast shuffle of a purchase of a corporation with its own funds or to a bank's irresponsible appropriation of a corporate depositor's funds to satisfy a stranger's obligations.

Calling the transaction "simultaneous" does not imbue Pierson or his associates with authority to dispense RCC corporate assets in fraud of creditors either before or after they acquired the shares, nor does it adorn with the corporate imprimatur Franklin's debiting of the corporate account for Pierson's purchase price checks.

The District Court correctly concluded that, while the "simple real estate closing" is "a fine example of a simultaneous transaction, it is not analogous to what should have happened when Tolmage, representing the selling shareholders, sold their RCC stock to Pierson and Olanow." A. 544.

It may be noted that a "doctrine de facto" is sometimes applied in the law of corporations, by which the acts of one not lawfully a director or officer will be deemed to bind the corporation when necessary to protect third persons dealing with such officers. See, Fletcher, *Cyclopedia of Corporations,* § 372. However, "[a] person is not a *de facto* officer unless he is occupying the office under some appearance or color of right" upon which the invoking party relies. Henn, *Corporations,* p. 150. Thus, the doctrine is not available to Franklin in this case, because it is Franklin itself which erected Pierson's "appearance" and applied the "color" to his transparent usurpation.

B. The Pierson letter was not an order to Franklin to issue checks and charge them against RCC's account.

Even if the certificate of corporate resolution could, by some legal alchemy, be deemed valid to authorize Pierson as a signatory against the corporate account before he had even purchased the shares, that resolution was no authority for what was done here. The $160,000 charge against the RCC account, in fact, directly contravenes the terms of the resolution.

The certificate of corporate resolution provided (Para. 1) that the bank is authorized to pay, cash or otherwise honor and charge to the corporation,

> ". . . any and all checks, notes, drafts, bills of exchange, acceptances, orders or other instruments for the payment of money or the withdrawal of funds"

when duly signed, made, drawn, accepted or endorsed on behalf of the corporation by a designated officer. A. 105.

The only document received by Franklin was Pierson's letter dated May 14, 1964. Pierson's letter, however, is not a check, draft, bill of exchange, acceptance, order or other instrument for the payment of money or the withdrawal of funds. The letter in its entirety is as follows, typed on an otherwise blank sheet (A. 107):

"May 14, 1964

"Franklin National Bank
130 Pearl Street
New York, New York 10015

"Gentlemen:

"Please issue your official checks to order of Sidney Tolmage in the amounts of $42,000.00 and $118,000.00 for delivery to him.

"Very truly yours,

/s/ RAY PIERSON
Roosevelt Capital
Corporation"

An "instrument" means a "negotiable instrument," a writing (a) signed by the maker, (b) containing an unconditional promise or order to pay a sum certain in money, (c) payable on demand or at a definite time, and (d) payable to order or to bearer. N.Y.U.C.C., §§ 3-102(1)(c), 3-104(1).

An instrument is a "draft" or "bill of exchange" if it is an order. N.Y.U.S.C. § 3-104(2)(a).

An "order" is a direction to pay and must be more than an authorization or request. It must identify the person to pay with reasonable certainty. N.Y.U.C.C. § 3-102(1)(b).

An instrument is a "check" if it is a draft drawn on a bank and payable on demand. N.Y.U.C.C. § 3-104(2)(b).

An "acceptance" is the drawee's signed engagement to honor the draft as presented. N.Y.U.C.C. § 3-410(1).

No esoteric analysis is required to see that, on its face, Pierson's letter is not a check, draft, bill of exchange, acceptance, order or other instrument containing a promise or order to pay a sum certain against the corporate account. It is no more than a request from Pierson that Franklin issue its checks for $118,000 and $42,000 payable to Tolmage.

Such a letter is not contemplated by the resolution, and the resolution does not authorize Franklin to indulge in suppositions, assumptions or faith in charging large sums against the RCC account.

Under the resolution, Franklin could charge the corporate account only pursuant to an "instrument", a limitation that accords with reason and the law. The legal, definitional requirements of the term "instrument" are intended to impart a modicum of safety to commercial transactions, as are the terms of the deposit agreement, and cannot be callously disregarded by the bank except at its peril.

The District Court correctly concluded that "[t]his letter was not an order to Franklin to issue checks and charge them against RCC's account." A. 544.

C. Pierson's unauthorized instruction to charge the RCC account for the purchase money cashier's checks cannot be deemed ratified after the fact.

Franklin's second argument is that, even if Pierson had no authority to apply RCC funds to his personal use before he purchased the shares, RCC may be deemed to have ratified his purloining of the corporate assets after he thus acquired control.

Established law prevents this offensive result. The prerequisites to corporate ratification of unauthorized acts are as follows:

> "If the officers or the agents of a corporation assume to act for the corporation without any authority at all, or if they exceed their authority or act irregularly, *and the act is one which could have been authorized in the first instance by the stockholders, board of directors or subordinate officers, as the case may be,* it may be expressly or impliedly ratified by them, and thus be rendered just as binding, except as to intervening rights of third persons, as if it had been authorized when done, or done regularly." 2 Fletcher, *Cyclopedia of the Law of Corporations*, § 752. (Emphasis added.)

Pierson was not an officer or agent of RCC at the time of his letter. But even if he had been, the question would be whether the payment of $160,000, without consideration to RCC, was an act "which could have been authorized in the first instance by the stockholders, board of directors or subordinate officers, as the case may be."

Fortunately for innocent creditors, the answer is firmly No.

Had the corporation, instead of Pierson, caused the payment without consideration of so much of the corporate funds as to reduce the corporation to insolvency, it would have acted in violation of, among other prohibitions, Section 510 of the New York Business Corporation Law, which prohibits unlawful dividends. That section provides:

> "(a) A corporation may declare and pay dividends or make other distributions in cash or its bonds or its property . . . on its outstanding shares, except when currently the corporation is insolvent or would thereby be made insolvent. . . .
>
> "(b) Dividends may be declared or paid and other distributions may be made out of surplus only, so that the net assets of the corporation remaining after such declaration, payment or distribution shall at least equal the amount of its stated capital. . . ."

Additionally and alternatively, since the payment was actually reimbursement to Franklin, had the corporation, and not Pierson, caused the payment, it would have acted in violation of Article 10 of the New York Debtor and Creditor Law, which prohibits fraudulent conveyances, a matter treated in the following section of this brief.

Therefore, since the request for payment contemplated an unlawful corporate act—an illegal dividend or a fraudulent conveyance—an act which could not have been authorized by the corporation in the first place, it follows that the request cannot be the subject of a presumed ratification. See *E. Moch Co. v. Security Bank of New York*, 176 App. Div. 842, 163 N.Y.S. 277, 282 (1st Dept. 1917).

It also follows that Franklin here was never graced with lawful authority to charge the RCC account, either before or after Pierson corruptly acquired RCC.

D. Even if RCC could be deemed to have authorized or ratified a request by Pierson to disburse RCC deposits to Franklin without consideration, Franklin would be liable to restore the funds as proceeds of a fraudulent conveyance.

Even assuming, *arguendo,* that RCC authorized or ratified Pierson's request that the bank charge the RCC account for reimbursement for the $160,000 cashier's checks, Franklin remains liable directly to the United States, RCC's judgment creditor, as transferee of a fraudulent conveyance.

The historic right of a creditor to set aside a fraudulent conveyance is substantially embodied in the Uniform Fraudulent Conveyances Act, enacted in New York in 1925, L.1925, c.254, as Article 10 of the New York Debtor and Creditor Law, §§ 270-280.* Section 278 of the N.Y. Debtor and Creditor Law provides:

> "Where a conveyance or obligation is fraudulent as to a creditor, such creditor, when his claim has matured, may, as against any person except a purchaser for fair consideration without knowledge of the fraud at the time of the purchase, or one who has derived title immediately or mediately from such a purchaser.
>
> "a. Have the conveyance set aside or obligation annulled to the extent necessary to satisfy his claim. . . ."

Assuming, *arguendo,* as Franklin asserts, that Franklin's reimbursement with $160,000 of RCC funds was a corporate

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* Local law determines whether a transaction is fraudulent as to creditors and, in any case of a fraudulent conveyance, Federal courts apply the law of the state where the transaction took place. *Benedict* v. *Ratner,* 268 U.S. 353, 359 (1925); *Robinson* v. *Elliott,* 22 Wall. 513, 89 U.S. 513 (1873); I Glenn *Fraudulent Conveyances and preferences* (Rev. Ed. 1940) § 620.

act of RCC, the undisputed facts show that that act was a fraudulent conveyance within the contemplation of the statute, subject to being set aside at the instance of RCC's creditor, the United States:

(1) By reason of a $157,229.17 judgment in its favor against Roosevelt Capital Corporation, the United States is a creditor whose claim "has matured." *

(2) $160,000 of RCC funds were conveyed ** to Franklin without consideration to RCC.

(3) The conveyance of RCC's $160,000 to Franklin was fraudulent in that, whether or not made with intent to defraud the United States, it was without consideration and it rendered RCC insolvent.***

That Franklin professes to have had no actual knowledge that the payment to it of $160,000 of RCC funds rendered the corporation insolvent, whether or not true, is irrelevant. Under the law of fraudulent conveyances, as under the law of bank liability for receiving misappropriated corporate assets discussed above and in the District Court decision, "[i]t is not necessary to the decision here that it be shown that when Franklin issued its official checks it had knowledge of RCC's assets and liabilities." A. 548. The law of fraudulent conveyances is clear that the grantee of a fraudulent conveyance who, like Franklin here, gave no consideration whatever to the grantor is bereft as a matter of law of the defense of "good faith" lack of

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* N.Y. Debtor and Creditor Law, § 278.

** N.Y. Debtor and Creditor Law, § 270: "'Conveyance' includes every payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property, and also the creation of any lien or incumbrance."

*** N.Y. Debtor and Creditor Law, § 273: "Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration."

knowledge. 1 Glenn, *Fraudulent Conveyances and Preferences* (Rev. Ed. 1940) § 233.

An illustrative case explains that, even if Franklin were shown to be

> ". . . free from a fraudulent intent in the transaction, such intent being established on the part of the insolvent [grantor], it was not necessary to prove that the bank acted with like intent. . . ." *Lehren-Krauss v. Bonnell,* 138 App. Div. 493, 122 N.Y.S. 866 (2d Dept. 1910).

In that case,

> "It is strenuously contended that, even if the [conveyance] is without consideration, the trustee cannot attack it, unless fraud is shown. . . ." 138 App. Div., at 496.

The court rejoined:

> "Conceding this proposition, its force is destroyed by the fact that in the case at bar insolvency of the mortgagor unites with want of consideration. *When both insolvency and want of consideration are shown, fraud is established."* 138 App. Div., at 496 (Emphasis added.)

So it is here. The charge of $160,000 rendered RCC insolvent, in fraud of its creditor. Franklin took $160,000 from RCC, but gave RCC nothing. In plainer terms, the law will not permit the bank to take something for nothing, and then claim "good faith" when it comes time to account.*

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* Indeed, whether this action be treated as an action upon a debt for the deposits, an action for restitution or for money had and received, an action to set aside a fraudulent conveyance or an action for damages for participation in the fraudulent misappropriation of RCC's funds, it is logical and the law in any case that Franklin need not be shown to have had any knowledge of what assets, if any, remained to RCC after the diversion of the $160,000 in order to hold Franklin responsible to restore or recompense that $160,000.

Franklin chose to "accommodate" Pierson, his companions, and the sellers. If it chose to be blind as well, or if it now pretends to have been, makes no matter. Neither Franklin nor any other bank

> ". . . may urge that it is ignorant of facts clearly disclosed in the transactions of its customers with the bank . . .; nor may a bank close its eyes to the clear implications of such facts." *Grace* v. *Corn Exchange Bank,* 287 N.Y. 94, 107 (1941).

In sum, as between the "accommodating" bank and the innocent creditor, the law and equity award the debtor's transferred assets to the defrauded creditor, by setting aside the fraudulent conveyance. Thus, if RCC could be said to have authorized the payment of $160,000 to Franklin, that payment was a fraudulent conveyance, now to be set aside in favor of the injured creditor, the United States.

E. Even if Franklin was not the recipient of the misappropriated RCC deposits, the bank would remain liable in damages.

Even if Franklin were, for any reason, deemed in law something other than the transferee of the $160,000 it charged against the RCC account for the cashier's checks, it would still be liable to RCC's creditor and receiver.

As seen above, not having had lawful authority to charge the $160,000 against the RCC account, the corporate deposits remain a debt owed the corporation by the bank.

Alternatively, if the RCC funds are deemed to have been actually paid out, though wrongfully, and even if Franklin were not deemed the recipient, Franklin would be liable in *damages* for participating in, or at the very least, facilitating, the fraudulent misappropriation of its depositors' funds. (The latter may be termed "gross negligence;" see,

e.g., Maley v. *East Side Bank of Chicago*, 361 F.2d 393 (7th Cir. 1966).

Likewise, were Franklin deemed to have charged the account upon the authority of RCC, and thus to have facilitated a fraudulent conveyance by RCC, it would be compelled to respond in damages to the innocent creditor, upon similar principles, for such wrongful participation or facilitation. See I Glenn, *Fraudulent Conveyances and Preferences* (Rev. Ed. 1940) § 56.

Recapitulation

The issue in this case is whether the undisputed facts warrant the District Court's determination that Franklin had sufficient knowledge of the misappropriation of the funds of its depositor, RCC, to be held liable for the loss that occurred.

The undisputed facts show and the District Court observed that, "[u]nder Franklin's own version of the facts, it had actual knowledge which may be termed, at the very least, embarrassingly complete," A. 548, and that "the papers before me clearly establish that Franklin paid out $160,000 of RCC funds pursuant to a purported corporate resolution which it knew was invalid." A. 548.

"Adopting Franklin's version of the facts," the District Court declared, "I am nevertheless compelled to conclude that this is a classic case of 'actual knowledge' and one which is far stronger than the cases cited by plaintiffs." A. 551.

Moreover, as shown above, even adopting Franklin's version of *the law*—i.e., that Franklin had authority from RCC to debit the RCC account—Franklin would remain liable to the United States, RCC's defrauded creditor, to restore the $160,000 Franklin received without consideration.

CONCLUSION

The decision and order of the District Court granting summary judgment to the United States and the Receiver of Roosevelt Capital Corporation was correct on the undisputed facts and the law and that decision and order, and the judgment entered accordingly, should be affirmed.

Respectfully submitted,

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AFFIDAVIT OF MAILING

STATE OF NEW YORK
COUNTY OF KINGS
EASTERN DISTRICT OF NEW YORK, ss:

DEBORAH J. AMUNDSEN, being duly sworn, says that on the 12th day of September 1974, I deposited in Mail Chute Drop for mailing in the U.S. Courthouse, Cadman Plaza East, Borough of Brooklyn, County of Kings, City and State of New York, a Brief for Plaintiffs-Appellees of which the annexed is a true copy, contained in a securely enclosed postpaid wrapper directed to the person hereinafter named, at the place and address stated below:

Julius Berman, Esq.
Kaye, Scholer, Fierman, Hays & Handler, Esqs.
425 Park Avenue
New York, New York 10022

Sworn to before me this
12th day of September 1974

[signature]

Qualified in Kings County
Certificate filed in New York County
Commission Expires March 30, 1975

[signature: Deborah J. Amundsen]
DEBORAH J. AMUNDSEN

SIR:

PLEASE TAKE NOTICE that the within will be presented for settlement and signature to the Clerk of the United States District Court in his office at the U. S. Courthouse, 225 Cadman Plaza East, Brooklyn, New York, on the ____ day of _____, 19____, at 10:30 o'clock in the forenoon.

Dated: Brooklyn, New York,
_____, 19____

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United States Attorney,
Attorney for _____

To:

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Attorney for _____

SIR:

PLEASE TAKE NOTICE that the within is a true copy of _____duly entered herein on the ____ day of _____ _____, the office of the Clerk of the U. S. District Court for the Eastern District of New York

Dated: Brooklyn, New York,
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United States Attorney,
Attorney for _____

To:

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Attorney for _____

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Action No._____

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n District of New York

—Against—

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l States Attorney,
ney for _____
and P. O. Address,
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